No. 88-54

In the Supreme Court of the United States

OCTOBER TERM, 1988

MICHAEL VITIELLO,
on behalf of himself and the
certified class of Data Access Systems, Inc.
shareholders, PETITIONER

v.

I. KAHLOWSKY & CO.,
PETER CUNICELLI,
TOLINS & LOWENFELS, and
ROGER A. TOLINS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONER

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Respondents argue that review is unwarranted because the decision below does not contravene this Court's precedents and creates no conflicts among the circuits. Respondents are wrong. This Court's precedents require application of a state limitations period to §10(b) actions. The Court's precedents, in fact, are so clear that until the decision below the courts of appeals unanimously so held. (Petition at 19-20). Similarly, this Court has always required tolling in cases of fraud, and its holdings on the point are so unequivocal that no court of appeals has ever held to the contrary. The *en banc*

decision of the court of appeals in this case thus fails to adhere to this Court's precedents on both the borrowing and the tolling issues, and creates an irreparable conflict with all the other courts of appeals on both questions presented in the petition.

Far from an unexceptional application of this Court's precedents in an area of minor importance, the decision below misapplies this court's precedents to securities fraud class actions *and* SEC injunction actions under §10(b) of the Securities Exchange Act. The court of appeals recognized (App. A, p.20) that "we must proceed on the assumption that Congress intends to borrow state law; we must borrow a state statute" — and then applied a *federal* limitations period to all §10(b) civil actions. The decision thus rejected this Court's rule that "[w]hen Congress has not established a time limitation for a federal cause of action, the settled practice has been to adopt a local time limitation as federal law" (*Wilson v. Garcia*, 471 U.S. 261, 266 (1985)), and failed to follow the teachings of this Court that "resort to state law remains the norm for borrowing of limitations periods." *DelCostello v. Internat'l Brotherhood of Teamsters*, 462 U.S. 151, 171 (1983).

Respondents' statement that "*Congress* has determined to limit tolling with respect to federal securities law claims" under §10(b) (Tolins & Lowenfels Br. 13) inverts reality: as this Court has recognized, "no statute of limitations is provided for civil actions under §10(b)" because the right of action thereunder was not created by Congress but by the courts. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976). See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 & n.10 (1983). Moreover, since the decision below imposes an untollable one-year limitations period on all §10(b) fraud

actions, respondents' suggestion that the new one-year limitations period may be "tolled" for up to three years is flatly wrong.[1]

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1. Respondents argue (Tolins & Lowenfels Br. 10-12) that this Court has never required application of a state limitations period to §10(b) actions. They are wrong. The precedents of this Court require application of a limitations period drawn from state law when none is supplied by federal law, and §10(b) actions are no exception. As the Court explained in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976): "[s]ince no statute of limitations is provided for civil actions under §10(b) [of the Securities Exchange Act], *the law of limitations of the forum state is followed* as in other cases of judicially implied remedies." (emphasis added). More recently, the Court reiterated the rule that in §10(b) cases, "*courts look to the most analogous statute of limitations of the forum state.*" (emphasis added). *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384 n.18 (1983).

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1. Although not relevant to the issues presented in the petition, we briefly address respondents' mischaracterization of petitioner's prosecution of this action in the district court. (Tolins & Lowenfels Br. 2-4). Respondents correctly note that petitioner refrained from suing them until the district court granted his motion for leave to amend in January 1986. In a classic case of concealed fraud, until the motion was filed in September 1985 petitioner lacked sufficient evidence of respondents' culpability to name them as defendants in a securities fraud suit. That evidence was uncovered in 1985 when, in separate litigation between DASI's auditors and bank creditors, petitioner obtained access to respondents' previously confidential deposition transcripts. Respondents' erroneous belief (Tolins & Lowenfels Br. 3) that petitioner could have conducted his discovery long before 1985 ignores the stay of all merits discovery that was in effect until after the district court's decision on class certification in the fall of 1984.

Respondents' implication that petitioner has not zealously conducted this litigation on behalf of the class he represents is unfounded. The lawsuit was vigorously pursued from its inception.

Nothing in *Wilson*, *DelCostello*, or *Agency Holding Corp. v. Malley-Duff & Associates*, No. 86-497 (June 22, 1987), changed this rule for §10(b) actions. Indeed, none of these decisions mentioned or qualified the rule in any way in the context of §10(b) litigation. To the contrary, all three decisions stress what *Hochfelder* and *Huddleston* made crystal-clear: district courts must follow the "longstanding practice of borrowing state law" for §10(b) limitations periods. (*Agency Holding*, Slip Op. 4). See *DelCostello*, 462 U.S. at 171 ("the norm"); *Wilson*, 471 U.S. at 266 ("settled practice"). The decision of the court below is flatly in derogation of the precedents of this Court. Review is warranted to correct the court of appeals' failure to adhere to this Court's precedents requiring borrowing state limitations periods for §10(b) actions.[2]

2. Contrary to respondents' belief (Tolins & Lowenfels Br. at 12), the decisions of this Court have for over a century expressed abhorrence of the concept that the perpetrator of a fraud can escape all civil liability for his conduct by simply concealing his wrongdoing until the statute of limitations has run. The Court has consistently and without deviation held that tolling is read into every limitations period governing claims that sound in fraud, to the end that "no man may take advantage of his

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2. In *Occidental Life Ins. Co. v. EEOC*, 432 U.S. 355 (1977), the Court declined to apply state limitations periods to EEOC enforcement actions to avoid the "direct conflict" that would otherwise occur between state statutes of limitations and "*the decision of Congress to delay judicial action* while the EEOC performs its administrative responsibilities." 432 U.S. at 368, 369 (emphasis added). Congress, of course, has never legislated a "delay of judicial action" for §10(b) cases, and there is accordingly no possibility that in the context of civil §10(b) litigation, "the importation of state law will frustrate or interfere with the implementation of national policies." *Id.* at 367. See *McAllister v. Magnolia Petroleum Co.*, 357 U.S. 221, 225-26 (1958) (same).

own wrong." *Glus v. Brooklyn Eastern District Terminal*, 359 U.S. 231, 232 (1959).[3]

The Third Circuit has now retroactively applied its new limitations period to a §10(b) case that was filed before the opinion below was issued. *Hill v. Equitable Trust Co.*, 851 F.2d 691 (3rd Cir. 1988). In so doing, the court of appeals has confirmed that it meant to eliminate tolling in §10(b) actions: "We concluded in *Data Access* that the appropriate period of limitations for section 10(b) and Rule 10b-5 cases was one year after discovery, with a maximum outside limit of three years from date of purchase." 851 F.2d at 698. The decision below, and the Third Circuit's decision in *Hill* to apply its untollable three-year limitations period to a §10(b) case filed before announcement of the new statute of limitations, have generated a flood of dismissal motions in securities fraud class actions throughout the country.[4]

3. Respondents erroneously assert that the decision below exempts SEC enforcement actions from its scope. (Tolins & Lowenfels Br. 10 n.2). But this Court has held that where, as here, a statute of limitations provides that "*any* civil action is time-barred unless filed within [a specified number of] years after the date it accrued," and

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3. Contrary to respondents' assertion here, petitioner argued before the court of appeals that the "one-year/three-year" limitations period contained in Sections 9(e), 18(c), and 29(b) of the Securities Exchange Act cannot be applied to §10(b) fraud cases because it contains (in respondents' words) a "built-in tolling cut-off." (Tolins & Lowenfels Br. 13).

4. *E.g.*, *In re Western Union Securities Litigation*, Master File No. 84-5092 (D.N.J.) (motion for dismissal on statute of limitations grounds); *In re AIA Industries Securities Litigation*, Master File No. 84-2276 (E.D. Pa.) (same); *In re Convergent Technologies Securities Litigation*, Master File No. C-84-20749(A) SW (N.D. Cal.) (same); *Grossman v. Texas Commerce Bancshares, Inc.*, 87 Civ. 6295 MJL (S.D.N.Y.) (same); *Bernstein v. Crazy Eddie, Inc.*, 87 Civ. 0033 EHN (E.D.N.Y.) (same); *Robin v. Doctors Officecenters Corp.*, 84 C 10798 (N.D. Ill.) (same); *Heideman v. Toreson*, Civil Action No. C-86-20024-SW (N.D. Cal.) (motion for leave to amend to add statute of limitations defense).

the "language makes no exception for civil actions by [the United] States," the government is "not entitled to an exemption from the strictures of" the limitations period. *Block v. North Dakota*, 461 U.S. 273, 287-88 (1983) (emphasis in original). The decision below clearly applies to all civil §10(b) actions, including those brought by the Securities and Exchange Commission.[5]

4. Respondents assert that the decision of the court of appeals has created no conflict among the circuits on the borrowing or tolling issues, and that this Court should therefore let the Third Circuit's resolution of the questions stand until all the lower courts have ruled. (Tolins & Lowenfels Br. 15-17). But all the courts of appeals *have* ruled, and they have ruled exactly the opposite to the holdings of the decision below. Petition at 19-20, 23-24. The conflict among the circuits is thus both complete and, since the decision below was rendered *en banc*, irreparable.

Every court of appeals that has considered the question after *Wilson*, *DelCostello*, and *Agency Holding* has explicitly rejected application of a federal limitations period to a cause of action arising under §10(b) and has applied the equitable tolling doctrine to the applicable

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5. Delay by the SEC in mounting its enforcement actions is inevitable. "In many instances proceedings for enforcement of the Securities Laws are begun *more than five years* after some of the alleged violative transactions have taken place. . . . Complaints are often made to the [Securities and Exchange] Commission, or alleged violations brought to its attention, long after the transactions involved have been consummated. The serious nature of an order of the Commission, for even a private hearing to determine whether there have been violations of the Securities Acts, ordinarily necessitates a long preliminary investigation by the Commission's staff and the preparation of a written report to the Commission by the investigating officer. . . . A lapse of more than five years from the date of the alleged violative transactions to the date of the formal order of the Commission is not extraordinary." Martenet, "Statutes Of Limitations On SEC Enforcement Proceedings," 41 Va. L. Rev. 59, 61 (1955) (emphasis added).

state limitations period. See *Durham v. Business Management Associates*, 847 F.2d 1505, 1508 (11th Cir. 1988) (specifically rejecting the borrowing and tolling holdings of the decision below); *Jensen v. Snellings*, 841 F.2d 600, 606-07 (5th Cir. 1988) (specifically rejecting the proposition embraced by the court below (App. A, pp. 22a & 32a) that §29 of the Securities Exchange Act "most closely resembles §10(b) and Rule 10b-5," and applying equitable tolling to the local limitations period); *Davis v. Birr, Wilson & Co., Inc.*, 839 F.2d 1369, 1369-70 (9th Cir. 1988) (rejecting the identical borrowing and tolling rules set forth in the opinion below).[6] Even before the opinion below was issued, at least *five* courts of appeals had specifically rejected application of federal limitations periods to §10(b) actions. *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888, 891-92 & n.6 (5th Cir. 1979) (rejecting application of §29(b) of the Securities Exchange Act); *Nickels v. Koehler Management Corp.*, 541 F.2d 611, 614 (6th Cir. 1976) (rejecting "a uniform statute of limitations of one year from discovery, up to a maximum of three years" drawn from Sections 9(e), 18(c), and 29(b) of the Securities Exchange Act); *United California Bank v. Salik*, 481 F.2d 1012, 1014 (9th Cir. 1973) ("federal courts have consistently rejected attempts to apply to §10(b) other statutes of limitation found in the [Securities Exchange] Act and in the Securities Act of 1933"); *Jordan Building Corp. v. Doyle, O'Connor & Co.*, 401 F.2d 47, 51 (7th Cir. 1968) (same); *Janigan v. Taylor*, 344 F.2d 781, 783 (1st Cir. 1965) (rejecting application of 1934 Act's limitations periods to §10(b) claims). See also *Lorenz v. Watson*, 258

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6. Sitting by designation in *Davis*, Senior Circuit Judge Aldisert of the Third Circuit (the author of the opinion below) separately expressed the views on §10(b) borrowing and tolling that just two months later would form the holding of his opinion in this case. 839 F.2d at 1370-76. But the Ninth Circuit in *Davis* rejected those views, and adhered to the borrowing and tolling precedents of that court. 839 F.2d at 1369-70.

F. Supp. 724, 733-34 (E.D. Pa. 1966) (expressly rejecting limitations periods contained in Sections 9(e) and 18(c) of Securities Exchange Act).

The district courts, too — including a district court within the Third Circuit — have reacted adversely to the decision below. See *Cohen v. McAllister*, 688 F. Supp. 1040, 1045 n.3 (W.D. Pa. 1988) ("The view [of the Third Circuit] that the fraudulent concealment doctrine does not apply in this [§10(b)] case flies in the face of Justice Frankfurter's statement that '[t]his equitable doctrine is read into every federal statute of limitations.' *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946)."); *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1442 (S.D. Cal. 1988) (applying equitable tolling and rejecting, *after* the opinion below, "the novel argument that in light of . . . *Agency Holding* the court should adopt a *uniform* statute of limitations for Rule 10b-5 claims") (emphasis in original). See 5C Jacobs, *Litigation and Practice Under Rule 10b-5* (2d ed., 1988 rev.) §235.02 at 10-6 to 10-10 & n.5 ("[T]he cases refuse to adopt . . . the statutes of limitations found in other 1933 Act and 1934 Act remedies"); 3A H. Bloomenthal, *Securities and Federal Corporate Law* §8.31[3][c] at 8-156.16 (1986) ("universally accepted that the federal doctrine of equitable tolling is read into the borrowed statute of limitations with respect to claims arising under Rule 10b-5").

5. Contrary to respondents' apparent belief (Tolins & Lowenfels Br. 18), the decision below directly and concretely affects petitioner and the certified shareholder class in this litigation. The judgment entered by the court of appeals *reversed* the district court's order denying respondents' motion to dismiss the §10(b) claim (App. B., p. 61a; App. C, pp. 66a-67a), and remanded "for further proceedings consistent with the opinion of this Court." (App. C, p. 67a). The holding of the court of appeals was "that the proper period of limitations for a complaint charging violation of section 10(b) and Rule 10b-5 is one year after the plaintiff discovers the facts

constituting the violation and, in no event, more than three years after such violation." (App. A, p. 32a). The motion to amend the complaint against respondents was filed in September 1985 and the complaint itself was filed in January 1986, more than three years after the 1981 time period involved in this case. Moreover, in *Hill v. Equitable Trust Co.*, 851 F.2d 691 (3rd Cir. 1988), the Third Circuit applied the decision below to a §10(b) case that was filed before the opinion below was issued. Petitioner has standing to seek review in this Court.

CONCLUSION

Respondents urge denial of review on the ground that the decision below is merely a routine application of this Court's precedents in an area of peripheral importance. Respondents, however, can minimize neither the substantial impact the court of appeals' decision is having on securities litigation in district courts throughout the country, nor the stultifying effect the decision below is exerting on "the congressional policy favoring private suits as an important mode of enforcing federal securities statutes." *Pinter v. Dahl*, No. 86-805 (June 15, 1988), Slip Op. 9.

Petitioner submits that this is one of those unusual cases that satisfies all standards of this Court for granting a writ of certiorari. The questions presented in the petition are ripe for decision and cannot be altered or illuminated by any further proceedings below. The question of the appropriate statute of limitations governing §10(b) actions is, in fact, most appropriately resolved at this time. *Wilson v. Garcia*, 471 U.S. 261, 264-66 (1985); *Agency Holding Corp. v. Malley-Duff & Associates*, No. 86-497 (June 22, 1987), Slip Op. 2-3; *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153-54 (1964). Guidance now from this Court on the issue will not only materially assist in efficient resolution of this litigation, but will

also materially assist all the lower courts in their consideration of §10(b) fraud actions.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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